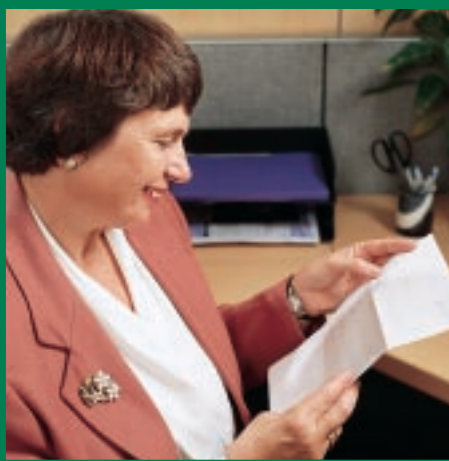


*Pride In OUR Service*



*Providing Confidence  
For YOUR Future*

The California  
Public Employees'  
Retirement System

OPERATIONS SUMMARY

Year Ended  
June 30, 1997

## PROFILE

The California Public Employees' Retirement System (CalPERS) is the nation's largest public pension fund and the third largest in the world, with assets at June 30, 1997 of approximately \$120 billion.

Headquartered in Sacramento, CalPERS provides retirement and health benefit services to more than 1 million people and more than 2,400 public employers. The System also operates seven offices located in San Francisco, Los Angeles, Orange County, San Bernardino, San Diego, Mountain View, and Fresno.

CalPERS is led by a 13-member Board of Administration, consisting of member-elected, appointed, and ex officio members.

Our membership consists of 750,712 active and inactive members from the State, school districts, and local public agencies, and 321,312 retirees, beneficiaries, and survivors.

Established by legislation in 1931, the System became operational in 1932 for State employees only. In 1939, other public agencies were allowed to contract with CalPERS to provide retirement benefits for their employees. We began administering health benefits to State employees in 1962 under the Public Employees' Medical and Hospital Care Act. Local public agencies joined in our health program on a contract basis five years later.

## ON THE COVER

Retired California Highway Patrol Officer Bill Rough (on right) took the time to write a word of thanks to Vicky J. Turner of the CalPERS Benefit Application Services Division. His letter is featured on page 25.



The California  
Public Employees’  
Retirement System

Comprehensive  
Annual Financial Report  
OPERATIONS SUMMARY

Year Ended June 30, 1997

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*Thank you so much for the CalPERS  
Procedures Manual as well as the list of  
representatives and their numbers...  
thank you also for highlighting in the  
manual those areas which are most  
pertinent to my needs. Your  
professionalism is greatly appreciated!*

*Tim Thomson  
West Hollywood, California*

Tim Thomson is an account clerk for the City of West Hollywood. He enjoys shopping at trendy stores along Sunset Boulevard, as shown here. Tim wrote to Ramona Lemos, who works in the Actuarial and Employer Services Division in Sacramento. As a retirement program specialist, she is a liaison to the agencies that contract with CalPERS.

*This note is to express appreciation for the help and courtesy extended to me by Tom Peck.*

*I desperately needed some material from my records for the Internal Revenue Service, and had some difficulty extracting the data ... until I contacted Tom Peck. He straightened things out and sent me the needed material promptly.*

*Ruth E. Hatcher*  
*Los Angeles, California*

Ruth Hatcher spent a career helping children as a social worker. She is now retired and enjoys reading. Tom Peck is a retirement program specialist in the Post Retirement Services Division in the Sacramento office.

## INTRODUCTION

### A Message to CalPERS Customers:

This year's Annual Report is dedicated to our customers and our vision for serving them — ***"Pride in OUR Service; Providing Confidence for YOUR Future."***

This vision drives our 13-member Board and the more than 1,000 employees who work for 1 million members. It will be met by remaining committed to our strategic planning goals, which include sustaining a high performance work culture, using our resources effectively, continuing to meet and exceed customer quality of service expectations, and delivering programs and benefits that are innovative and sensitive to customer needs.

Contained in this Operations Summary is our progress report in meeting these goals and living this vision. It includes our financial highlights and a status report on each program — from retirement benefits and health-related efforts, to our investment portfolio and a list of new laws implemented during the last fiscal year.

We have woven throughout this report the faces and opinions of a few of the many CalPERS members who have graciously shared how they feel about their experience with us. We are sharing portions of these heart-felt messages as a reminder of our commitment to our customers. We remain committed to reaching our goals and achieving our vision — providing service that makes us proud and providing confidence to our members for their financial future.

The Financial Highlights on the next page demonstrate the exceptional year CalPERS had in investment returns and program performance. Our diligence in money management enables us to meet our strategic plan goal of effectively organizing and focusing resources to assure that sufficient funds are available to pay benefits and to minimize costs to public employers in the State.

## FINANCIAL HIGHLIGHTS

### Public Employees' Retirement Fund (Unaudited)<sup>1</sup>

	1997	1996
<b>Assets</b>		
Cash & Cash Equivalents	\$10,179,191	\$9,104,357
Investments, at Fair Value	125,879,646,911	99,984,935,915
Receivables	2,786,306,373	2,349,973,820
Other Assets	70,833,443	82,081,880
<b>Total Assets</b>	<b>\$128,746,965,918</b>	<b>\$102,426,095,972</b>
<b>Liabilities<sup>2</sup></b>	<b>\$7,585,198,288</b>	<b>\$726,978,755</b>
<b>Net Assets Held in Trust for Pension Benefits</b>	<b>\$121,161,767,630</b>	<b>\$101,699,117,217</b>

### Additions & Deductions

	1997	1996
<b>Additions</b>		
Member Contributions	\$1,379,743,571	\$1,338,044,978
Employer Contributions	1,986,282,287	1,850,103,438
Investments Income	20,147,569,883	13,135,454,838
Other	308,296,547	1,747,245
<b>Total Additions</b>	<b>\$23,821,892,288</b>	<b>\$16,325,350,499</b>
<b>Deductions</b>		
Retirement, Death, & Survivor Benefits	\$4,097,295,852	\$3,846,390,136
Refunds	153,688,959	138,296,520
Administrative Costs	108,257,064	80,682,335
<b>Total Deductions</b>	<b>\$4,359,241,875</b>	<b>\$4,065,368,991</b>
<b>Increase in Net Assets Held in Trust for Pension Benefits</b>	<b>\$19,462,650,413</b>	<b>\$12,259,981,508</b>

Complete financial information of all the Funds administered by CalPERS can be found in the Comprehensive Annual Financial Report for the year ended June 30, 1997.

#### Note:

<sup>1</sup> Differences in the amount shown for investment assets in these Financial Highlights and the Investment Portfolio amount reported in the Investments Section of this summary are due to differences in reporting methods. In accordance with GASB Statement No. 28, financial statements include Securities Lending Collateral. Also, Net Investment Receivables/ Payables are not included here.

<sup>2</sup> The increase for the year ended June 30, 1997 is due to the fact that the System implemented GASB Statement No. 28, and accordingly, recorded liabilities to brokers for security lending collateral held of approximately \$6.5 million.

## PRESIDENT'S MESSAGE

### Dear CalPERS Member and Stakeholder:

Fiscal year 1996-97 was a banner year at CalPERS, and it is the dedicated CalPERS employees who deserve much of the credit. It is altogether appropriate that we showcase the excellent customer service their dedication provides. Please note that throughout the pages of this report we are giving credit where credit is due, using the words of CalPERS members as expressed in their many personal letters of gratitude.

The Board of Administration adopted a vision statement, "Pride in OUR Service; Providing Confidence for YOUR Future." It is a vision that is simply stated but a challenge to achieve. Our Board and staff are committed to this vision.

In the past fiscal year, the quality of our work was enhanced with the implementation of core values that promote quality, respect, accountability, integrity, and openness. Managers and supervisors are now held accountable for displaying those values.

June 30, 1997 signaled the end of the first year of our five-year strategic plan. We have completed many of the tasks necessary to reach our planned goals and objectives related to improving our services, and we have placed special emphasis on improvement of our technology infrastructure.

To ensure that future benefits will be administered in the most efficient manner, we began the processes necessary to guarantee our computer systems will continue to function in the Year 2000. A critical element in this strategy is continuing the development of our integrated

Corporate Database. Where possible, the Board has chosen to invest in building new computer systems rather than expending funds to make the old systems Year 2000-compliant.

Another important milestone in the Corporate Database project this past fiscal year was the implementation of the corporate registration system. This new system allows employers to enroll members into the retirement program on-line, and makes information more accessible and easier to use. By the end of the year, 24 employers had partnered with us to use the corporate registration system and 12 million records were converted to the new database. Work will continue in 1997-98, including expanding on-line access for the Health Benefits Program and initiating new computerized accounting and investment reconciliation systems.

For 1997-98, we have sharpened our focus to implement key projects that will provide us with the technological tools needed to maximize staff effectiveness. We will be working to help CalPERS employees sharpen their old skills and develop new ones, and strive to provide a healthy work environment for all CalPERS employees. We will continue to improve communication with members and re-engineer processes with the objective of improving customer satisfaction.

CalPERS members can take comfort from the fact that we again exceeded our objective of high investment returns while carefully managing risk. The Fund grew from \$101.7 billion to \$121.2 billion, earning an approximate 20.1 percent return on its investments.

Even with all their work, our employees still made time to volunteer to help others who are less fortunate. CalPERS employees pledged \$71,695 to the United Way, contributed 21,060 pounds of food to local charities, raised money for the March of Dimes, donated 302 pints of blood to the Sacramento Blood Bank, and established mentor and tutor relationships with local schools.

We are proud of our accomplishments during the past year, and of the people who made them happen. The challenge before us is to continue to improve our programs and processes so that we can provide our members with the confidence that we will deliver their benefits when they are due. Our responsibility to provide financial security to those we serve remains our primary focus.

Respectfully submitted,



**William Dale Crist**

President

CalPERS Board of Administration



*William Dale Crist*



## CalPERS BOARD OF ADMINISTRATION

### William Dale Crist

President  
Employee Member  
(elected by State members)  
Professor, CSU—Stanislaus  
Term Ends: January 15, 1999

### Charles P. Valdes

Vice President  
Employee Member  
(elected by all members)  
Counsel, Department of Transportation  
Term Ends: January 15, 1998

### Ronald Alvarado

State Personnel Board Member  
(designated by the State Personnel Board)  
Term Ends: Serves at the pleasure of the State  
Personnel Board

### Robert F. Carlson

Retired Member  
(elected by retirees)  
Retired—Chief Counsel,  
Department of Transportation  
Term Ends: January 15, 2000

### Thomas J. Clark

Elected Official of Local Government<sup>1</sup>  
Former Councilman, City of Long Beach  
Optometrist  
Term Ends: January 15, 1999

### Kathleen Connell

State Controller  
Ex Officio Member

### Jerry Cremins

Public Representative<sup>2</sup>  
[ Thru March 1997 ]  
position vacant

### Michael Flaherman

Employee Member  
(elected by public agency members)  
Economist, Bay Area Rapid Transit  
Term Ends: January 15, 1999

### Matt Fong

State Treasurer  
Ex Officio Member

### William Rosenberg

Employee Member  
(elected by all members)  
Retired—Retirement Specialist, CalPERS  
Term Ends: January 15, 1998

### Kurato Shimada

Employee Member  
(elected by school members)  
Supervisor of Operations  
Oak Grove School District  
Term Ends: January 15, 1999

### Joseph A. Thomas

Official of Life Insurer<sup>1</sup>  
Board of Directors, Best Life Assurance Company  
Term Ends: January 15, 2001

[ Harry Bubb ]  
[ Thru March 1997 ]

### David Tirapelle

Director, State Department of Personnel  
Administration  
Ex Officio Member

### Notes:

<sup>1</sup> Governor appointee.

<sup>2</sup> Appointed jointly by the Speaker of the Assembly and the Senate Rules Committee.





*Despite having attended a workshop and reading the written material provided by CalPERS, my process of retirement was more “complex” than I could master... mostly a case of not knowing what questions to ask.*

*I greatly appreciated the opportunity to have worked with Robert Frame in your office. His patience, knowledge, and professional manner leaves me confident that I was well aware of the options and particulars and have established the best possible retirement options for myself and family.*

*I was fortunate to have the assistance of your excellent benefit program specialist.*

*Catherine Mason, M.D.  
Napa, California*

Catherine Mason practices adult, child, and adolescent psychiatry. Robert Frame is a retirement program specialist in the San Francisco office, helping members prepare for life after their working years.

## CalPERS BOARD COMMITTEES

In addition to their regular duties, Board Members also serve on permanent and ad hoc committees to review specific programs, projects, or issues and make recommendations to the Board. The following committees were active as of June 30, 1997.

### Benefits & Program Administration

Michael Flaherman, Chair

Ronald Alvarado, Vice Chair

Robert F. Carlson

Matt Fong

Kathleen Connell

William Rosenberg

William D. Crist

This committee reviews all matters related to benefit program structure, actuarial studies and rate setting, retirement program policy, and administrative issues.

### Executive Performance & Compensation

Thomas J. Clark, Chair

Robert F. Carlson, Vice Chair

William D. Crist

Charles P. Valdes

Kurato Shimada

(vacant)

Joseph A. Thomas

This committee studies and evaluates compensation mechanisms and criteria, develops policies and procedures, and makes recommendations to the Board concerning compensation of key personnel.

### Finance

Robert F. Carlson, Chair

Kathleen Connell, Vice Chair

William D. Crist

David Tirapelle

Michael Flaherman

Charles P. Valdes

Matt Fong

This committee provides financial oversight on all budget matters, evaluates funding alternatives, oversees preparation and recommends approval of the CalPERS budget, and oversees the CalPERS annual and periodic audits by both internal and external audit units.

## Health Benefits

**Kurato Shimada, Chair**

**Charles P. Valdes, Vice Chair**

Thomas J. Clark	William Rosenberg
Kathleen Connell	David Tirapelle
Matt Fong	(vacant)

This committee oversees the administration of the Public Employees' Medical & Hospital Care Act program, and the Public Employees' Long-Term Care Act program.

## Investments

**Charles P. Valdes, Chair**

**William D. Crist, Vice Chair**

Ronald Alvarado	William Rosenberg
Robert F. Carlson	Kurato Shimada
Thomas J. Clark	Joseph A. Thomas
Kathleen Connell	David Tirapelle
Michael Flaherman	(vacant)
Matt Fong	

This committee reviews investment transactions, the investment performance of both internal and external managers, and establishes investment policy and strategy.

## Strategic Planning

**David Tirapelle, Chair**

**Michael Flaherman, Vice Chair**

Thomas J. Clark	Joseph A. Thomas
Kathleen Connell	William Rosenberg
Matt Fong	

This committee oversees the strategic planning process, including selection of consultants, defining process direction, and monitoring implementation of the CalPERS Strategic Plan.

## Investments Subcommittees

### Policy

**David Tirapelle, Chair**

Robert F. Carlson	Charles P. Valdes
-------------------	-------------------

This subcommittee conducts an inventory of all existing investment policies, procedures, and guidelines for review by the Investment Committee. It reviews and recommends revisions to these on a priority basis. This subcommittee is also charged with developing a manual of policies, procedures, and guidelines, and a process for periodic revisions.

### Real Estate

**Michael Flaherman, Chair**

**David Tirapelle, Vice Chair**

Robert F. Carlson	Charles P. Valdes
Thomas J. Clark	(vacant)
William Rosenberg	

This subcommittee develops real estate investment portfolio strategies, policies, and procedures for Investment Committee approval.

## Other Committees

### Ad Hoc Committee to Review Board

#### Information Requirements

**Michael Flaherman, Chair**

Robert F. Carlson	Charles P. Valdes
William Rosenberg	(vacant)
Kurato Shimada	

This committee determines what information the Board requires, organization and presentation of that information, frequency, and distribution. The committee also reviews technology to improve, develop, disseminate, and reduce the overall cost of providing information to the Board and other parties.

## CalPERS STAFF

### Executive Staff

**James E. Burton**

Chief Executive Officer

**James H. Gomez**

Deputy Executive Officer

**Robert Aguallo**

Assistant Executive Officer

Investment Office

**Vincent P. Brown**

Assistant Executive Officer

Financial & Administrative Services

**Kayla J. Gillan**

General Counsel

**Sandra C. Lund**

Assistant Executive Officer

Member & Benefit Services

**Patricia K. Macht**

Chief, Office of Public Affairs

**Sheryl Pressler**

Chief Investment Officer

Investment Office

**Ron Seeling**

Chief Actuary

Actuarial & Employer Services

**Margaret Stanley**

Assistant Executive Officer

Health Benefit Services

**Robert D. Walton**

Assistant Executive Officer

Governmental Affairs, Planning & Research

### Divisions

**Tom Britting**

Chief, Office of Audit Services

**Tom Fischer**

Chief, Office of Long-Term Care

**Tim Garza**

Chief, Management Information Systems

**Pat Harris**

Chief, Benefit Application Services

**Barbara Hegdal**

Chief, Member Services

**Mitzi Higashidani**

Chief, Information Technology Services

**Bryant Hughes**

Administrator, Data Administration

**Gary M. Jones**

Chief, Field Services

**Michael W. Koester**

Chief, Operations Support Services

**Ron Kraft**

Chief, Fiscal Services

**Jeff Lung**

Information Security Officer, Office of Information Security

**Ken Marzion**

Chief, Actuarial & Employer Services

**Susan L. Myers**

Chief, Office of Governmental Affairs

**Chris Nishioka**

Chief, Post Retirement Services

**Michael Ogata**

Chief, Planning & Research

**Tom Pettey**

Chief, Human Resources

**Steve Phillips**

Chief, Change Management Office

**Fred Steinmetz**

Chief, Health Plan Administration

**Janet Toney**

Chief, Health Benefit Services

### Area & Field Offices

**Nancy Carter**

Manager, Northern Region

**Pat Largent**

Manager, Bay Area Region

**Cora Williams**

Manager, Southern Region

**Cory Antflick**

Manager, San Bernardino Field Office

**Anita Commer**

Manager, San Francisco Area Office

**Elaine Edwards**

Manager, San Diego Field Office

**Brenda Fortune**

Manager, Sacramento Area Office

**Debra Gibson**

Manager, Orange County Field Office

**Charles McClamma**

Manager, Mountain View Field Office

**Edith Mercer**

Manager, Los Angeles Area Office

**Steve Pietrowski**

Manager, Fresno Field Office





CalPERS Executive Staff from left to right:  
(seated in front) Kayla Gillan, Sheryl Pressler;  
(second row) Sandra Lund, James H. Gomez,  
James E. Burton (seated), Margaret Stanley,  
Patricia Macht; (back row) Vincent Brown,  
Robert Walton, Ron Seeling, Robert Aguallo.

## YEAR IN REVIEW

*Fiscal year 1996-97 was a productive one for CalPERS. We continued to implement our five-year strategic plan, dedicated to serving our customers better, enhancing our investment returns, and administering our programs more efficiently and effectively. We made progress in four key areas — strengthening benefit administration, expanding our customer programs, aggressively pursuing improvements to our health benefits program, and increasing our assets responsibly. These accomplishments, which are summarized in the pages that follow, are stepping stones for serving our 1 million members into the next century.*

## PROVIDING BENEFITS

In an increasingly competitive market, CalPERS believes superior service is the single most important indicator of success. Simply stated, improving our ability to provide benefits in a cost-efficient and effective manner allows us to positively impact the lives of those we serve.

CalPERS provides a variety of services to meet the varying needs of members. We administer service and disability retirements, refunds, and death benefits. CalPERS also administers health benefits, and we offer general retirement education and information services, so that members can plan ahead.

In the 1996-97 fiscal year, our benefit programs included nine retirement formulas and 55 employer contract choices. We added 14,889 new retirees to the payroll and paid out \$4.1 billion in benefits. Our total membership remained over 1 million.

In an effort to reach more members and increase their awareness, CalPERS conducted 180 financial planning seminars throughout the State in the past year. More than 11,000 people attended the sessions — a 64 percent increase in the number of seminars, and a 55 percent increase in attendance from the previous year.

Members attending seminars receive information on identifying and setting financial goals, investment concepts, budgeting and debt control, insurance and tax planning, CalPERS benefits, Social Security, deferred compensation programs, and estate planning.

Just like our members, employers who contract with CalPERS are provided with a wide range of services. During the year, our Actuarial and Employer Services Division reviewed valuations for more than 1,800 employer contracts. They handled 80,000 employer telephone inquiries and 229 contract amendments. Processing was done for 17 million payroll records and payroll reporting training was provided to nearly 800 agencies.

CalPERS also conducted 10 forums during the year for school employers, attended by representatives of 192 school districts. The purpose of the forums was to enable school employers to seek information in addressing payroll reporting and compensation issues.

For the first time, CalPERS conducted actuarial workshops to fully explain an employer's annual actuarial valuation and to gather input on new policies. Approximately 300 agency representatives attended. Contribution rates were also adopted for all employers. While the public agency employer rates won't take effect until the 1998-99 fiscal year, the State and school rates were established for the 1997-98 fiscal year.

These employer rates are: 6.172 percent for Schools; 12.721 percent for State Miscellaneous First Tier; 9.822 percent for State Miscellaneous Second Tier; 9.048 percent for State Industrial; 13.754 percent for State Safety; 15.515 percent for the California Highway Patrol; and 15.270 percent for Peace Officer/Firefighter.



*My husband and I would like to thank you for all your help in filling out all our forms... You're very patient and understanding, something hard to find in this world...*

*I pray everyone else in your life treats you as nice.*

*Catherine Kender  
Long Beach, California*

Alphonse and Catherine Kender enjoy shopping at antique and thrift stores. They also have a keen eye for yard sales. Their letter was written to Maggie Lee, an office technician in the Orange County office. CalPERS office technicians provide clerical support and answer general questions about the System, among other duties.



*...I would like to comment on the cooperation of all departments in CalPERS that I have been in contact with, usually when I'm totally confused. Everyone has been very helpful and I'm always able to get an answer to my questions.*

*In particular I have talked to Esteban Vasquez several times — actually, I ask for him because he has been so patient. I told him he would be sorry for being so helpful because now he was stuck with me. Maybe this letter of appreciation can be noted for his “above and beyond” assistance.*

*Laura Blevins  
Orland, California*

For 16 years, Laura Blevins has been City Clerk of Orland, a community with 5,668 residents. Esteban Vasquez is an enrollment processor in the Health Benefit Services Division in the Sacramento office. He enrolls public agency members into the System.

## PROVIDING BENEFITS (continued)

Providing benefits requires diligent oversight. That's why last year we initiated new review processes, including a two-year pilot project to prevent fraudulent disability retirements. The project is a joint effort by our Benefit Application Services Division and the investigations unit of the Legal Office. The group, known as the Disability Validation Team, reviews applications and investigates those with questionable issues.

The Benefit Application Services Division also developed new guidelines to ensure community property orders are in compliance with law. CalPERS co-sponsored legislation allowing the spouses of local peace officers and firefighters killed in the line of duty to remarry without losing their benefits. Those members who had previously elected a 25 percent reduction to protect their benefits were restored to the full amount. Additionally, an on-line final compensation calculation program was developed to provide more accurate and quicker benefit calculations.

### CalPERS Estimated Benefit Payments

*\$ in Billions*

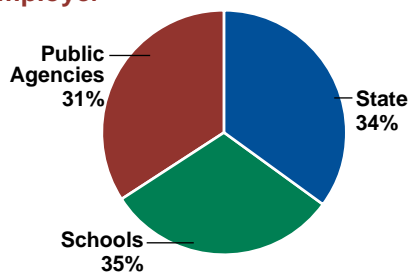


To help improve understanding of our programs and services, we expanded distribution of our pre-retirement video during the year. Approximately 2,100 videos were distributed to public agency and school employers and employee and employer organizations.

Our Web site, "CalPERS On-Line," was launched in January 1997 and was visited nearly 400,000 times in the first six months of operation. The site has more than 300 electronic pages of information about our services, programs, investments, and financial planning seminars. There is also information about retirement and health benefits, employer services, Board meeting schedules, and upcoming special events. It also features a downloadable program for estimating monthly retirement benefits.

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#### **Membership by Employer**



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Establishing a web site was among the significant steps CalPERS made in updating our technology systems, which provide for enhanced customer service. A new integrated Corporate Database system was launched, and although it is several years away from completion for all its processes, it already gives employers the opportunity to submit member transactions through an on-line paperless process with a personal computer. At the close of the fiscal year, 24 employers had connected on-line through our corporate registration system, conducting transactions for such things as retirement plan enrollments, separations, address changes, and coverage group changes.

Another technology improvement is a new actuarial valuation system developed and used to complete the State and school actuarial valuations. Once the system is fully functional, in the 1997-98 fiscal year, it will automatically select data directly from our databases, feed the data into a calculation program to calculate actuarial liabilities and contribution rates, and print custom-designed reports. The new system will allow CalPERS to provide employers with much more information, at a greater level of detail than in the past.

CalPERS is aware that superior performance means not only supplying benefits but also serving and meeting the needs of members. Customer service is our top priority, and it is our focus today and in the future.

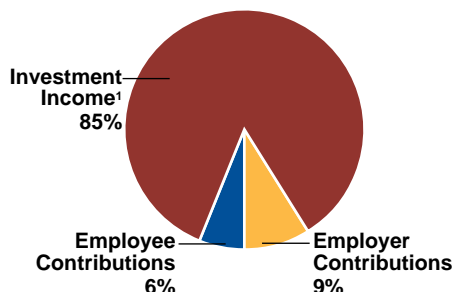
#### **Retirement (PERF) Program Facts**

- 750,712 active and inactive members
- 321,312 retirees, beneficiaries, & survivors
- 14,889 new retirees
- \$4.1 billion paid in benefits
- 2,425 contracting public agency employers (includes school districts)

## ADDING VALUE AND SECURITY

Confidence in the future is based in part upon the service we provide, and that includes exercising safeguards to ensure the accuracy of benefit payments. A lot goes on behind the scenes at CalPERS to make this happen.

**CalPERS Income**



Periodic staff audits and independent outside auditors validate the accuracy of our benefit payments. Our calculation processes are also checked in this manner. These measures safeguard against errors like those found in a recent federal government audit, when it was revealed that 8 percent of private sector retirees in fully funded plans that terminate are being shortchanged in their pensions when they accept lump-sum payments.

The CalPERS Office of Audit Services performs compliance audits of our contracting agencies. The audits focus primarily on whether the agencies are appropriately enrolling employees and accurately reporting member earnings. A total of 82 such audits were completed for the fiscal year. When performing audits, a risk factor is developed which takes into account whether there are high amounts of special compensation, notable pay rate increases, and the conversion of sick leave to additional service credit at retirement.

**Note:**

<sup>1</sup> Includes gains in fair market value in investments and gains in sales of securities.

Another way we ensure proper benefit payments is by doing tests on payroll information submitted on retirement applications. When the calculation program is initially run, the test prints discrepancy messages for pay rates that exceed certain percentages. It also prints special compensation that exceeds certain amounts over the last few years prior to retirement. Discrepancies are reviewed and analyzed to confirm that the compensation was reported in compliance with State law.

Members can monitor their accounts by using the Annual Member Statement they receive. The statement summarizes their account activity, and changes in service credit and contributions. For many members over age 45, the annual statement also provides an estimated retirement allowance.

In keeping with our responsibility to guarantee the soundness of future benefits, CalPERS challenged legislation which delayed State employer contributions to the pension fund. We took this fight all the way to the California Supreme Court after the Sacramento Superior Court and State Court of Appeals ruled that the State illegally withheld payment from the System. Ultimately, the State was ordered to pay back \$1.2 billion plus interest.

CalPERS staff issued 38,000 retirement estimates, processed 13,600 retirement applications, and administered 2,500 disability retirements.

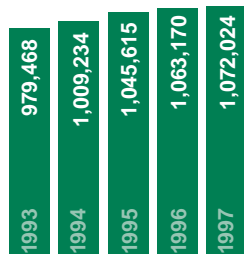
More than 1.2 million member calls were fielded in our telephone centers in the Benefit Application, Health Benefit, Post Retirement, and Member Services Divisions. Of the more than 185,000 calls received in the Benefit Application Services Division, 97.8 percent were answered on the first try, without the caller getting a busy signal. The Post Retirement Services Division, which handled over 207,000 calls during the year, assigned more staff during

peak call times to provide better customer service. Our seven field offices responded to more than 255,000 phone calls — 33,427 handled in the Sacramento Area Office alone.

We evaluated 30 external money managers and screened the performance of 1,500 companies to determine whether they should be targeted for corporate governance activism by CalPERS. Taking advantage of new technologies, we also implemented a new “cash deposit” system which takes the place of manually posting money that enters the System. In its first year, we used the new system to post more than 67,200 checks, totaling \$2.3 billion.

### Total Membership

*Five-Year Review*



To evaluate our customer service, CalPERS utilizes effectiveness measures. Done on a quarterly basis, the measures monitor workload performance data. During 1996-97, 99.3 percent of member contribution refunds were paid within 30 calendar days. Ninety-five percent of all requests for benefit eligibility determinations in the Long-Term Care Program were processed within 10 working days, and 96 percent of post-retirement death benefit claims were paid to eligible beneficiaries and survivors within 90 days of notification of the death.



*I applied for my retirement on a moment's notice. Today, I deposited my first retirement check!*

*I would like you to share this letter with Steve Hansen. I appreciate him helping me through this time in my life by handling my application and talking to me and easing my concerns...He was so nice and professional and wonderful.*

*And last, but certainly right up there at the top also, I would like to extend my appreciation to the personnel at CalPERS who initially helped me begin the process of retiring.*

**Dorothy M. West**  
Sacramento, California

Dorothy West shares her home with two cats (Clint is pictured). Over a period of 30 years at the State Department of Corrections, Dorothy was the secretary for three different deputy directors. Steve Hansen works in the Benefit Application Services Division as a benefit program specialist. He calculates service and disability retirement benefits.

*I am writing to express my appreciation for the assistance provided me by Kimberly Mayhugh in the CalPERS Mountain View Field Office.*

*I went to CalPERS seeking help in determining information on my retirement date and benefits. I have been a member of CalPERS for about 30 years... In short, my benefits projection was very difficult and time consuming.*

*Ms. Mayhugh did an excellent job in answering my questions in a timely manner and pointing out issues that I should be aware of. She also assisted me in a very friendly and courteous manner.*

*I have always been proud to be a member of CalPERS, and working with Ms. Mayhugh further strengthens my belief that CalPERS is an excellent organization.*

*John C. Smith*  
*Mountain View, California*

Before he retired this year, John C. Smith worked for nearly nine years as a criminal investigator for Santa Clara County. He investigated computer crimes, but upon retirement he traded in his briefcase for scuba diving gear. Kimberly Mayhugh was a retirement program specialist in the Mountain View office where she presented retirement workshops and seminars to members. Kimberly is now a member of the CalPERS Corporate Database Project in Sacramento.

## ADDING VALUE AND SECURITY (continued)

Our members can have confidence that their future will be free from financial worry by participating in programs that help plan for retirement: the CalPERS 457 Public Agency Deferred Compensation Program, the Department of Personnel Administration's (DPA) Savings Plus Program, the CalPERS Supplemental Contributions Program, a tax-deferred payroll deduction plan for service credit purchases, the CalPERS Member Home Loan Program, and the CalPERS Long-Term Care Program.

The CalPERS 457 Public Agency Deferred Compensation Program is available to public agency employers to offer their employees. There are more than 155 agencies participating in the program, with 3,000 participants. Assets totaled an estimated \$45 million in the past fiscal year.

Employees of the State of California can also save for their retirement by investing a part of their income through the DPA Savings Plus Program. CalPERS performs investment services for three mutual funds in this program: the U.S. Treasury Short-Term Fund, which grew by 5.2 percent over the year to \$38.4 million; the U.S. Treasury Intermediate-Term Fund, which grew by 7.1 percent to \$40.2 million; and the S&P 500 Index Fund, which grew by 34.4 percent to \$196 million.

The CalPERS Supplemental Contributions Program is another way for members to add to their retirement savings. While contributions are made with after-tax dollars, the earnings are tax-deferred. Contributions are invested with the CalPERS investment portfolio, ensuring the CalPERS net earnings rate.

During the year, we began a tax-deferred payroll deduction plan for service credit purchases for members of public agencies and County Superintendents of Schools. Individual employers who choose to participate in this program provide their employees the option of deferring income tax liability on member service credit purchases. By the close of the fiscal year, 241 public agencies joined the program.

The CalPERS Member Home Loan Program offers financing to CalPERS members to help purchase a home. This program includes conventional home loans of 95 percent of the purchase price. It can be combined with the Personal Loan Program for those members with contributions on account. They can borrow an amount up to 5 percent of their loan, resulting in a 100 percent home loan if needed. The personal loan is secured by the member's retirement account, which is used as collateral.

The value of home loans increased from \$405 million in fiscal year 1995-96 to \$452 million in 1996-97. CalPERS has loaned \$1.7 billion in home loans and \$30.7 million in personal loans since inception.

The CalPERS Long-Term Care Program is available to any public employee, their spouse, parents, and parents-in-law. Three options are available, allowing members to choose a plan that best meets their needs. Enrollments increased during the year from 40,000 to 72,271, with premiums exceeding \$80 million. For the 1996-97 fiscal year, CalPERS paid out \$1 million in long-term care benefits.

At CalPERS, we do more than just administer benefits. Our continued responsiveness, and our commitment to the business of building secure financial futures is what gives our members confidence for the future.

### **CalPERS Program Facts**

- More than 72,000 members enrolled in the Long-Term Care Program
- Long-Term Care Program premiums exceeded \$80 million
- More than 155 agencies participated in the 457 Public Agency Deferred Compensation Program, with over \$45 million invested in fiscal year 1996-97
- \$452 million loaned through the Member Home Loan Program



## TO YOUR HEALTH

As a national leader in health care purchasing, the CalPERS Health Benefits Program turned its focus to patient-focused care, innovative partnerships with some of our contracting health maintenance organizations (HMOs), and expanded member education. Providing access to quality health care choices at an affordable price is central to the services we provide our members.

During fiscal year 1996-97, health program membership increased nearly 3 percent as we topped the 1 million mark. Of those we cover, 65 percent are State members and 35 percent are school and public agency members. We processed 179,000 health plan enrollment documents, completed 23,000 health open enrollment transactions, and responded to more than 500 written requests for health benefits assistance. More than \$1.5 billion in health care premiums were paid during the year.

While experts were predicting double digit inflation in the industry, we held the line with an average premium increase of only 2.7 percent for the HMOs in the upcoming contract year. HMO Supplement to Medicare and Managed Medicare premiums increased an average of 5.2 percent. We also signed our first three-year contract with a health plan, PacifiCare, which can help stabilize cost fluctuations.

Our cost containment was done while also expanding benefits. Active members and those in Supplement to Medicare plans now have a hearing aid benefit. HMOs also committed to alert members, in advance, to any changes in the lists of approved drugs and to minimize changes in the physician and hospital networks that our members use.

Our method of using market competition, performance reports, and customer satisfaction surveys to improve the quality of medical care and to bring down costs, continues to be an example for national reform. In April, CalPERS went to the nation's capital and testified before a U.S. Senate Special Committee on how to improve information on health plans for Medicare beneficiaries.

Providing good customer service also means being an advocate for patients and looking for new ways to assist them. When a dispute broke out between a health plan and its medical providers, CalPERS stepped in because provider disruptions negatively impact doctor-patient relationships. A full-page newspaper advertisement by CalPERS publicly asked the parties to put an end to their dispute and get back to the business of taking care of patients.

This year, CalPERS launched several innovative partnership programs, working with various health plans to improve the health of those we serve. In cooperation with Health Net, we began a project that has identified nearly 8,000 CalPERS members who are at moderate to high risk of cardiovascular disease — the number one killer of Americans. These members are being offered help in lowering their risk and improving their health.

We also began another venture with Health Net and four medical provider groups to make it easier and quicker for patients to gain access to specialists. By the end of the fiscal year, the project had completed 600 phone interviews to find out what problems block access. Once the problems are identified, the next step will be to develop "best practices" solutions.



Another partnership project is under development in our self-funded plans — PERSCare and PERS Choice. This program educates those with asthma on how to avoid attacks and emergency room visits. Free breath-testing devices will be provided to help predict attacks, so they can be prevented.

For our own employees, the “California Works Well” program was started. Risk assessment profiles on 500 volunteers were completed, checking for early signs of major ailments like stroke, heart attack, and diabetes. Assistance in making lifestyle changes in diet, exercise, smoking, and stress reduction to reduce that risk were offered. Walking programs were developed and are being regularly utilized.

In addition, we enhanced and expanded our annual Open Enrollment materials, because making good health care choices comes from getting good information. With the input of members, CalPERS developed materials in an easy-to-use format for choosing a plan, understanding the program, and coordinating benefits with Medicare. Materials also provide HMO customer satisfaction information, quality performance reports, and premium comparisons.



*I retired from State service in July of 1995, and had the pleasure of working with Shirley Kuykendall...She was always courteous, patient, human, professional and, needless to say, she has an outstanding personality. I could always depend on her returning my calls and giving me the answers to my questions.*

*...During this time in life when we are all too busy to stop and enjoy the flowers, I would like to let her know how much I appreciated her help. Good service is never forgotten, and continue to keep up the good work.*

*Ruth B. Stevenson  
Oakland, California*

Ruth Stevenson wasn't at a loss for things to do after she retired. She has many hobbies, including flying kites, making stained glass windows, working with youth groups, and repairing computers. Shirley Kuykendall works in the San Francisco office as a retirement program specialist. Shirley conducts workshops and seminars.

*During a difficult period of time in my personal life, I accepted the responsibility of taking care of an elderly aunt... Luckily, I made the “right turn” and contacted the PERSCare office. The first person I spoke to approximately four years ago was Ron Davies...*

*My next calls were answered by yourself (Liz Lott). I don’t know how I can ever thank you for all the help you gave to me...*

*My other “thank you” must go to Lisa Sargent... In my opinion, each and every one of you have done an outstanding job in helping me get through this period...*

*John A. Bystry  
Princeton, Illinois*

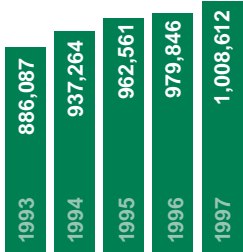
When John A. Bystry contacted CalPERS, he was struggling with insurance issues involving his aunt, a retiree of the State Department of Highways. Ron Davies, Liz Lott, and Lisa Sargent work in the Health Plan Administration Division in the Sacramento office.

## TO YOUR HEALTH (continued)

As we work to improve the quality of health care, we view customer surveys as a vital indication of how well our health plans are performing. This year’s satisfaction survey showed that once again most CalPERS members are happy with their health plans, with their physicians, and with their access to medical specialists. We mailed 15,000 questionnaires to a random sampling of CalPERS members in all our health plans, including both HMOs and preferred provider organizations (PPOs), with an almost 48 percent response rate. The questionnaire focused on their experiences with physicians, medical care, covered services, and plan administration.

### Total Health Program Membership

*Five-Year Review*



In the area of customer service improvements, we focused on streamlining the Open Enrollment process — our busiest time of the year. New technology is now in use to make the process faster, more accurate, responsive, and efficient. We began reviewing transaction documents so that errors could be identified and corrected before they could be placed into our database. As a result, CalPERS members now receive their identification cards in a more timely manner than ever before.

Health plan enrollment is always an area of concern for retirees, who often have special needs. To reassure retirees that their plan changes were being processed, and to reduce the need to call CalPERS, we now send an acknowledgment postcard to any retiree making a change during Open Enrollment.

During the year, major federal health legislation was passed with the signing of the Kennedy-Kassebaum health insurance reform bill, also known as the Health Insurance Portability and Accountability Act. CalPERS was actively involved with Congress in drafting key provisions of that Act. Because most of the reforms in the Act were already standard procedure at CalPERS, there was minimal effect on our health program. The new law did, however, change our process for certain “late enrollments” outside the normal Open Enrollment period.

In April, the Board of Administration launched one of our most innovative health projects. After extensive consultation with our various constituent groups, the Board challenged the health industry to come forward with new ideas for taking health care into the 21st century.

We are especially interested in finding ways to make our self-funded PPOs more affordable for members who prefer this more traditional type of coverage. A new concept of using risk adjustment in setting rates will be considered to help level the playing field in premium costs.

A new “point of service” health plan, described as halfway between an HMO and a PPO, will also be examined, as will an “exclusive provider organization” — a private label HMO, designed to CalPERS specifications.

It is certain that health care will continue to be a topic of debate in the State and national arenas. CalPERS remains dedicated to being the advocate for our members. In turn, this will aid all users of the health care system. At the same time, our focus on innovation and quality will forge new frontiers in health benefits administration.

### Health Program Facts

- 1,008,612 participants
- 65 percent of participants are State members
- 35 percent of participants are school and public agency members
- 1,126 participating public agencies
- \$1.5 billion paid in health care premiums
- 179,000 enrollment documents processed

## INVESTMENTS

The financial future of our members is secure and growing steadily as we exceeded our objective of high investment returns while carefully managing risk.

The CalPERS investment portfolio experienced tremendous growth during the 1996-97 fiscal year, earning more than \$19 billion. The Fund's total portfolio market value at June 30, 1997 was \$119.7 billion. The System earned a return of 20.1 percent on its investments, well above last year's performance of 15.3 percent. This performance marked one of the largest annual gains by the System in recent years and illustrated the Fund's sustained strength and growth.

The Board's asset allocation decision to increase the Fund's exposure to the U.S. equity market once again served as the foundation of the Fund's success. We witnessed our U.S. equity investments earn an astounding 30.6 percent, backed by Wall Street's record-breaking bull market. Furthermore, the resurgence of the Japanese stock market, combined with the sharp appreciation of the yen, provided a wealth of gains for U.S. investors. Our international equity portfolio provided a solid return of 18 percent.

The stock market's strength sustained several trends throughout the year. Corporate restructuring boomed, privatization brought foreign companies to the U.S. market, institutional investors steadily increased their foreign share ownership, and there was virtually a rush into the world's emerging markets. In all, the markets provided some very attractive opportunities, and we took advantage of them.

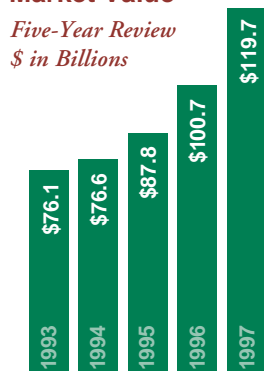
In December 1996, we formed an historic partnership with the prestigious Asian Development Bank (ADB), committing \$225 million to make long-term, direct private equity investments in the emerging markets of the Asian-Pacific region. The strategic alliance was an international first, both for CalPERS and the international multilateral bank. The investments were targeted to finance a variety of ventures, including industry and financial services in the region. It was a pioneering effort for the Fund and allowed access to the excellent opportunities that are unparalleled in the region. Moreover, the partnership spanned a bridge for cross-capital flows between Asian Pacific investors and California companies.

Overall, the Fund's alternative and private equity investments earned 14.4 percent for the year.

The fiscal year marked a focused effort on individual corporate board performance and accountability in the System's Domestic and International Corporate Governance Programs. In a major expansion, we embarked on the next evolutionary step of our shareholder activism. We began the development of a set of model U.S. "Corporate Governance Principles" to serve as one institutional investor's perspective on issues of board independence and leadership, board processes and evaluation, and individual board member characteristics. The principles will be designed to foster debate in the corporate governance arena and — as a whole — will be important considerations for all companies within the U.S. market who wish to survive in today's increasingly competitive environment.

## Growth of Investment Portfolio — Market Value

*Five-Year Review  
\$ in Billions*



upon the legal, economic, and cultural traditions of each country. Moreover, the principles reflect the core of the corporate/shareholder relationship addressing accountability, transparency, equal treatment for all shareholders, voting methods, and long-term corporate vision. Using these as a core foundation for our international shareholder activism efforts, we further developed Corporate Governance Principles for our investments in the United Kingdom and France.

The effort was timely. Global competition drove the reassessment and restructuring of corporate governance systems in several foreign countries. The principles served as a road map to influence the emergence of shareholder-oriented programs abroad.

And once again, the Board adopted a two-tier approach to our Corporate Governance Program, targeting 10 “focus” companies and increased monitoring of 20 other poorly performing companies.

Additionally, CalPERS was vigilant in the first year of the System’s International Corporate Governance Program. The Board formally adopted a set of global governance principles and best practices that focused on six basic concepts that are fundamental to free and fair markets throughout the world, without impinging



*This is my last official act as a California Highway Patrolman. As of 1700 hours today, my career will end and I will never again wear the uniform my wife and I worked so hard to keep. This is not an easy thing for me, but with help from people such as Vicky Turner, this was made much easier for me and my family...I guess all she really did was care about her job and the people whose lives she impacted. It seems so simple, but yet so hard to find in a person. I didn’t want Vicky’s efforts to go unnoticed, and I would ask you to thank Vicky in a manner fitting her integrity.*

*Officer Bill Rough  
Atwater, California*

Bill Rough holds the badge he wore for eight years as a California Highway Patrol officer. He retired on February 1, 1997. Vicky J. Turner is an ombudsperson in the Benefit Application Services Division in the Sacramento office.

*I am writing to highly commend the performance and ingenuity of Nancy Michaels in her position as manager of the Volunteer Firefighters' Length of Service Award System...The volunteers of California have a good program and they mainly have Nancy to thank for it.*

*Nancy has been extremely helpful and responsive to the volunteers' needs and problems. Her skills in public relations and legislative abilities are rare to find.*

*Mike Frees  
Washington, D.C.*

Mike Frees is the California director of the National Volunteer Fire Council. He is also chairman of the volunteer committee of the California State Firefighters' Association, and in that capacity, he has worked closely through the years with Nancy Michaels, who manages the Volunteer Firefighters' Length of Service Award System.

## INVESTMENTS (continued)

CalPERS exercised its stature as a leader and activist in the private equity market as well. Working with eight of the nation's top public pension funds, we campaigned for better terms and conditions as a limited partner investor in the private equity market. We challenged general partners to adhere to some model best practices that would ensure fair general partner compensation, greater alignment of interests, and increased accountability. The recommendations were outlined in a private equity partnership study conducted by William M. Mercer, Inc. and represented the first time public pension funds collaborated on such an industry report.

The "Key Terms and Conditions for Private Equity Investing" documents widespread concern about the way in which equitable terms and conditions have evolved with private equity partners. The study addressed two fundamental questions: Are financial interests aligned between general partners and limited partners? Do the ongoing management practices of partnerships represent a continual alignment between general partners and limited partners?

It identified over 30 terms and conditions in private equity contracts which could be improved or added in the limited partner/general partner relationship. By creating best practices in compensation structure, information disclosure, and accountability, CalPERS laid the foundation for increased cost savings and long-term quality of limited partnership investments.



Of equal importance, our excellent investment performance came at a low cost to the System. According to a study issued by Cost Effectiveness Measures, Inc. (CEM) in November 1996, the Fund’s investment-related expenses were extremely cost effective, without sacrificing the quality of the investment program. The study concluded that CalPERS spent one-tenth of 1 percent of the Fund’s value, \$96.8 billion at that time, on investment-related expenses. We achieved value-added investment results equal to or in excess of other large pension systems.

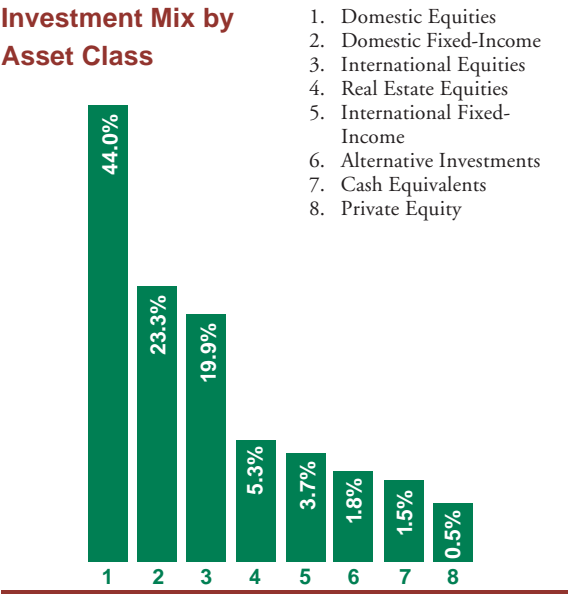
In an effort to narrow our costs further, the Board voted to support the Common Cents Stock Pricing Act of 1997, which implemented decimal pricing of equity securities. The change makes it simpler for investors to know the price of equities and could potentially offer savings for investors by a reduction in the spread — the difference between the price paid by the trader to buy the equity and the price charged by the trader to sell the stock. By the fiscal year-end, we witnessed U.S. stock exchanges transition in the new pricing system. It is estimated that when complete, CalPERS may save more than \$1 million annually on reduced trading spreads in equity transactions.

**Investment Policy & Strategy**

The Board has investment authority and sole responsibility for the management of assets. A complete set of policies serves as a guide for the Investment Committee, management, and staff for carrying out the daily activities of the investment program. Investment policies are formally reviewed through the System’s Investment Policy Subcommittee and receive final approval by the Investment Committee.

One of our most important policies and investment strategies is our asset allocation decision. It is essentially the starting point, and most important component, for CalPERS to achieve successful returns on investments. It is ultimately the way the Fund diversifies stocks, bonds, cash, and other investments that is largely responsible for the System’s returns. The allocation decision is not an asset-only or liability-only decision. All factors, including liabilities and contributions, are taken into account in determining the appropriate asset allocation mix. The Board approves a target allocation with investment range guidelines for each asset class.

**Investment Mix by Asset Class**





## INVESTMENTS (continued)

There are two types of asset allocations: strategic and tactical. Strategic asset allocation is the basis for long-term asset allocation targets for each asset class. Within each class, ranges are included in the policy to provide the flexibility to take advantage of market opportunities. Information is received from staff, research services, and money managers. This forms the tactical asset allocation which allows shifts between classes to take advantage of emerging or rapid market opportunities.

In addition to the asset allocation policy, the following investment objectives have been established for the portfolio.

### *Inflation*

Achieve a total portfolio return of 4 percent in excess of the U.S. Consumer Price Index.

### *Actuarial*

Achieve a total portfolio return above the assumed actuarial interest rate, at 8.5 percent for the period July 1, 1996 through June 30, 1997.

### *Performance*

1. For the internal equity index portfolio, achieve a return equal to the Wilshire 2500 Index, plus or minus 50 basis points.
2. For externally managed assets, meet specific performance objectives related to their investment style, which are outlined in their contract.
3. For internal domestic fixed-income instruments, achieve a return in excess of the Salomon Brothers Large Pension Fund Index.
4. For equity real estate, achieve at least a 5 percent real rate of return.
5. For alternative and private equity investments, achieve an annual hurdle rate of 15 percent.

## Redefining Our Approach

To ensure continued strong earnings and prudent management of risks well into the next century, comprehensive investment strategies were developed and implemented in our alternative investment and private equity, real estate, and global public markets portfolios. With these strategies in place, we began a process of specialized oversight and management of these programs.

### *Alternative Investments & Private Equity*

CalPERS began a proactive approach to the private equity market during the year. The effort stemmed from a report completed early in the year that found the System's alternative investment and private equity portfolios were well-positioned for growth, but could benefit from greater flexibility and responsiveness in an often fast-paced market.

The Board reorganized the way we invest in the private equity market. We consolidated the Fund's three existing programs, including our Alternative Investment, Alternative Emerging Investment Opportunity, and Private Equity programs, into one program — the Alternative Investment Management (AIM) Program. We began proactively seeking investment opportunities that offered the best value on a risk-adjusted basis. We streamlined our internal approval process to allow the Fund to react quickly to market opportunities. We sought to continue profitable general partnerships and expand our direct investment efforts.

AIM provided CalPERS more direct control over the types of investments in the program, and sent a clear message to the investment community about the type and structure of deals worthy of consideration.

The Board allocated 3 percent of the total Fund for investment in alternative investments and 2 percent to private equity investments that include co-investments as part of the AIM program. AIM had approximately \$5.4 billion in commitments to 84 limited partnerships investments, of which over \$2.1 billion was invested. Approximately \$666 million was committed to eight direct investments and co-investments.

### *Real Estate*

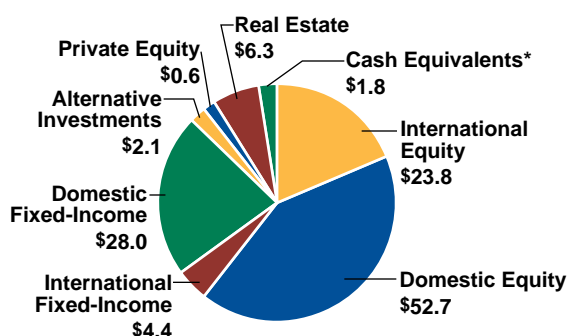
CalPERS continued to evaluate and analyze our real estate portfolio during the year in an effort to maximize returns. Our Real Estate Subcommittee and investment staff worked diligently to develop and begin implementing a comprehensive strategy for the System's \$4.2 billion core real estate portfolio of apartment, office, industrial, and retail properties. The Investment Committee delegated the authority to implement the strategic plan to the System's senior investment officer for real estate, which grants staff authority over asset transfers, tactical asset allocation, acquisitions and dispositions, retention/termination of the System's real estate advisors, and implementation of approved plans.

The strategy fosters a new approach toward the management structure and policies of our real estate portfolio. It calls for maximized focus and dedication by requiring a team of real estate professionals who work exclusively on the CalPERS portfolio; allocates existing real estate assets into subportfolios based on property type and region; maximizes alignment of interests through co-investment and fee structures based on cost, to effectively implement the strategy with the majority of fees paid only when CalPERS realizes profits; and provides CalPERS the opportunity to consider strategic alliances with management teams, including investment advisors and public and private operating companies.

The strategy has several advantages. A dedicated team ensures clear lines of responsibility and accountability with an understanding of the CalPERS approach and objective. It also provides a focus by property type and region that helped facilitate selection of management teams on expertise in specific metropolitan areas. Furthermore, the strategy's fee and co-investment structure provides an incentive for superior performance and aligned interests with CalPERS. The System's real estate portfolio earned 13.5 percent, well above the NCREIF Property Index return of 10.2 percent for the year.

### **Investment Portfolio — Market Value**

*\$ in Billions*



\*Includes \$372.9 million in net receivables/payables.

By the fiscal year-end, we had begun implementing a nationwide search for teams to manage the System's apartment, office, industrial, and retail portfolios. In addition, we began program reviews of our remaining \$2.1 billion in the portfolios devoted to specialized real estate assets such as timber, housing, land, and other specialized programs.

*I have had the pleasure of working directly with Karen Barsch, supervisor of the Enrollment and Eligibility Section on many occasions.*

*Fortunately, I met Karen during the Open Enrollment period when our agency first joined CalPERS. Since that time I have called upon Karen many times to assist in situations I was unsure how to handle. Even though at times I am sure she was quite busy, she has always followed through handling each situation with efficiency.*

*Each time I have contacted Karen, I felt confident the matter would be resolved, and it was. She listens, and is very patient, taking the time to explain things simply and clearly.*

*Judith Zanier  
San Ramon, California*

Judith Zanier is an administrative aide for the San Ramon Valley Fire Protection District. Karen Barsch was working in the Health Benefit Services Division in Sacramento. Karen now helps design the health and medical requirements for the new Corporate Database Project.

## INVESTMENTS (continued)

### *Global Public Markets*

Public market investments represent the largest portion of our investment portfolio. More than \$76 billion was invested in the U.S. and international equity markets and roughly \$32.4 billion invested in domestic and international fixed-income at the end of the fiscal year.

Approximately 84 percent — or \$44.3 billion — of the Fund's domestic equity assets are passively managed internally and \$1.3 billion are managed by one external small capitalization passive manager, while the remaining 13 percent — or \$7.0 billion — are managed actively by external fund managers. The System's \$28 billion domestic fixed-income portfolio is managed internally, while the total international portfolio valued at \$28.2 billion is managed externally, using 14 investment managers.

During the year, CalPERS began the first phase of a new public market strategy. The Board voted to reorganize management of the domestic equity portfolio. The plan authorized the development of an internal active management capability to manage a portion of the Fund's domestic equity in-house; revamped the pay-for-performance fee schedule to better align interests of CalPERS and its manager; created specialized benchmarks for each manager for evaluation and monitoring purposes; called for a specialized passive management fund to complement active management performance; and streamlined the external manager contract solicitation process to attract more applicants capable of adding value to the Fund.

The strategy also marked a first for the System. CalPERS launched an interactive nationwide search for active domestic equity managers and a passive small capitalization manager on the World Wide Web. It was a tall order for a public agency that historically solicited bids through voluminous paper invitations under stringent rules. The Request For Proposal (RFP) was designed to attract a broad universe of potential firms that were capable of adding value to the Fund. With the RFP, we tapped into available technology to provide interested bidders with a simple, accessible, easy-to-use process. Traditional searches brought the System about 80 proposals. Our Internet RFP netted 270 proposals — a 300 percent increase.

### A California Focus

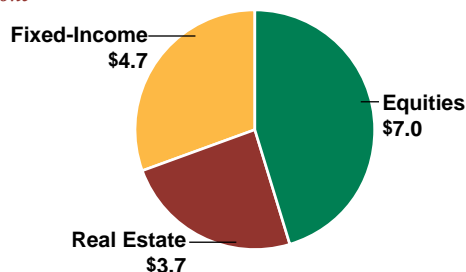
Fulfilling our commitment to seek investments that strengthen California's economy, we continued a proactive approach in making prudent investments in the State. Through a number of programs, including private equity investments, limited partnerships, single family housing, acquisition and development, and home loans, we diversified our portfolio, while providing a powerful economic stimulus to California's growth. Approximately \$15.4 billion was committed by the System for investment in California, of which \$14.8 billion was invested.

The Single Family Housing Program continued to generate new home construction in California. With a \$525 million allocation, the program pulled in returns in excess of 20 percent. We continued to diversify and manage our portfolio while providing thousands of jobs and services. In addition, the System allocated \$455 million in its Acquisition & Development Program, a residential land development program exclusive to California. Of our total real estate investments, approximately \$3.7 billion were committed for investment in our State.

We sought to provide valuable venture capital for the State's innovative high technology and biotech industries through limited partnerships in the System's AIM Program. Approximately \$555 million was committed for investment in eight limited partnerships that take advantage of a number of factors conducive to targeted investment activity within the State, including the unique size characteristics of California's economy and the State's large number of business entities and development cycles.

### California Committed Investments

*\$ in Billions*



#### Note:

Additional information on CalPERS investment policies, operations, investment results, and detailed asset information can be found in the 1997 Annual Report of Investments.

## LEGISLATIVE HIGHLIGHTS

### State Update

Developing legislative positions and proposals that serve the interests of our members is a priority of the Board of Administration. As a guide in formulating positions, the CalPERS Board uses its own Legislative Policy Standards.

The following is a brief summary of some of the CalPERS-related legislation that was enacted during the first year of the 1997-98 Session of the California Legislature. (New laws become effective January 1, 1998, unless otherwise noted.)

#### *AB 38 , Chapter 389 (Figueroa)*

Creates the “Newborns’ and Mothers’ Health Act of 1997” requiring that health plans provide hospital coverage for at least 48 hours following a normal vaginal delivery and 96 hours for a Cesarean section. The bill provides benefits which are very similar to those provided by federal law passed last year, becoming effective January 1, 1998. The bill applies to all contracts renewed on or after August 27, 1997. (Effective August 27, 1997.)

#### *AB 1595, Chapter 951 (Assembly Public Employees, Retirement & Social Security Committee)*

Makes technical changes to the Public Employees’ Retirement Law by renumbering, deleting, and revising various sections. The bill includes an optional, alternate retirement plan subject to collective bargaining for less than half-time classified school employees not currently eligible for the CalPERS defined benefit program. It also provides for an extension of the two-year golden handshake provision for local agencies until January 1, 1999.

#### *SB 629, Chapter 386 (Karnette)*

Extends the special death benefit provided by CalPERS to State Miscellaneous and Local Miscellaneous members, to include beneficiaries of classified school members who die as a direct consequence of a violent act that arose out of and in the course of official duties.

#### *SB 969, Chapter 584 (Burton)*

Requires the Judicial Council, in cooperation with CalPERS, to conduct a study and make recommendations to the Legislature on the feasibility and desirability of increasing or eliminating the age at which a judge may retire without a reduction in retirement allowance under the Judges’ Retirement System and Judges’ Retirement System II. The report is to be submitted to the Legislature on or before March 1, 1998.

#### *SB 1072, Chapter 585 (Burton)*

Requires the Judicial Council, in cooperation with CalPERS, to conduct a study and prepare a report to the Governor and the Legislature on the feasibility and desirability of providing judges in deferred retirement and sitting on assignment, with service credit under the Judges’ Retirement System and Judges’ Retirement System II.

#### *SB 1192, Chapter 458 (Schiff)*

Extends an existing public agency option that allows public agencies (other than schools) to offer an additional one to four years of service credit for retiring employees until June 30, 1999.

## Federal Update

Our Federal Relations Program continued in 1996-97 to ensure that the interests of the System, our members, and employers were addressed in the overall federal policy-making process.

CalPERS was successful in getting exempted from the so-called “nondiscrimination” rules issued by the Internal Revenue Service. The rules were designed to prevent higher income, executive-level employees in the private sector, who often control the creation of their companies’ pension plans, from setting up a benefit structure that favors them to the detriment of the rank-and-file employees. But their rigid uniformity requirements would have been impossible for public plans to meet because of the way in which governmental benefit formulas are designed to reflect the many differences among careers in the public sector.

Applying the rules would have been extremely costly and administratively burdensome for CalPERS. Worse yet, in order to protect members from the loss of federal tax deferral on pension contributions, compliance with the IRS rules could have required major revisions in carefully crafted benefit structures.

Fortunately, CalPERS efforts to educate Congress and the Administration on the important differences between public and private sector plan structures, administrators, and members — so important to the public pension community’s hard-fought 1996 legislative victory to reform the Section 415 benefit limitation rules — continued to pay off.

The year provided other examples of the importance of our close monitoring of developments at the federal level that could impact our programs and our members. When changes were proposed to the tax rules governing “purchase-of-service-credit” programs, CalPERS fought to ensure the proposals would work for the System. CalPERS then joined with other public pension plans and employer and employee groups to obtain the adoption of these amendments to Section 415 ensuring the long-term viability of this important portability feature for governmental plans.

During 1997, CalPERS was also actively involved in discussions on Capitol Hill on the quality of Medicare managed care. CalPERS presented testimony at a hearing of the Senate Special Committee on Aging detailing how our health program provides the most comprehensive and understandable health plan information possible to our Medicare beneficiaries.

Next year promises to be both challenging and full of opportunity for CalPERS and the public pension community, as Congress continues to explore ways to encourage retirement savings. Portability issues will remain an important focus of discussion, but perhaps the most serious debate will center on the future of Social Security and the long-term needs of Medicare.

Extending Social Security coverage to all public employees will certainly be one of the more important features of such a debate, but there will be other issues with potentially significant implications for CalPERS. These include the impact of the possible privatization of Social Security on investment and corporate governance issues, and the implications for the future of defined benefit plans of a possible move to individually-directed Social Security accounts.



## THE YEAR AHEAD....

This report has reviewed highlights of a successful first year of our five-year strategic plan. Times of transition always require “extra effort,” and that effort has been expended by our staff.

As we start the second year of our plan, seven “key” projects are underway. The projects concentrate on improving our technology infrastructure, our organizational infrastructure, and advancing our customer service effectiveness.

We are implementing an integrated planning, budget, and project management support process. By tying these efforts together into a single disciplined process, we are effectively linking project plans and schedules with the funding and the staff resources needed to perform those projects.

Two of the key projects — Corporate Database and Year 2000 Compliance — are intricately related and are fundamental to deliver service in the 21st century. They reflect our most urgent need and a significant future asset: up-to-date records and access to those records for our members and our employers.

Our commitment to service will be strengthened through the development of a customer service business plan, reengineering of our business processes, and internal communications and training. CalPERS believes that developing our “best assets,” our employees, is just as critical to our future success as having the best business plan and information systems. To this end, we are stepping up employee communications and staff training efforts to ensure we are operating effectively.

We will balance our assets and liabilities as part of our mission to provide financial security to all those we serve. Our ongoing focus is to guarantee sufficient funds are available to pay for current and projected benefit payments to members, retirees, and beneficiaries, while minimizing and stabilizing employer contributions. This project will help establish strategic asset allocation targets based upon consideration of complex factors regarding future economic and financial conditions.

### The 1997/98 Seven Key Projects

**Corporate Database** — Our objective is to move to a paperless environment that allows data to be easily shared and accessed, increasing convenience to users, and enhancing the System’s ability to gain and maintain its advantage in the marketplace.

**Year 2000 Compliance Project** — It is imperative that all computer systems, particularly those that support CalPERS health and benefit programs, work in the Year 2000. We also will ensure that any new computer systems, internal and external business enterprises, and contractors are Year 2000-compliant.

### Customer Service/Business Process

**Reengineering** — CalPERS is dedicated to being a high performance, customer-driven organization. To meet the needs of our customers and increase customer satisfaction, we will assess how changes will guarantee improved service.



**Asset & Liability Management** — This project aims to achieve our goal of safe, secure, and stable funding for benefits. To that end, we will explore in an integrated fashion, projected liabilities, benefit payments to current and future retirees, and the assets available to meet the current and projected payments.

**All Staff Training** — This project develops core skills training programs for all staff. It represents the first step in a multi-year, evolving program, designed to increase organizational performance.

**Communication** — This project will assure that we will include an internal communication and an Internet/Intranet technology infrastructure plan. Also, we will identify and develop strategies and tactics for an effective internal communication program. The ultimate goal will be to provide the environment for every employee to effectively and efficiently obtain the information and business knowledge needed to manage change and improve performance.

**Planning, Budget, and Project Management** — This project will develop and implement an integrated planning, budget, and project management system to streamline organizational planning and project management efforts. By investing in the development of enterprise-wide projects, the appropriate structure, resources, and decision paths will be identified early and considered in the decision-making process.



*After the loss of my daughter, Kelly Tilyou (Abels), it has been most difficult attending to my normal personal and business affairs.*

*It is a pleasure to thank you very much for giving me your time in a personal meeting to attend to my problems at such an emotional time for me. Further, I was impressed with the clarity and speed that you resolved the problems but also helped lift quite a burden from both my family and myself.*

*Robert Tilyou  
Rio Linda, California*

Robert Tilyou fondly remembers his daughter through the photograph he holds. He wrote to Chris Nishioka, who is the chief of the Post Retirement Services Division.

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